

# FDIC State Profile

FALL 2003

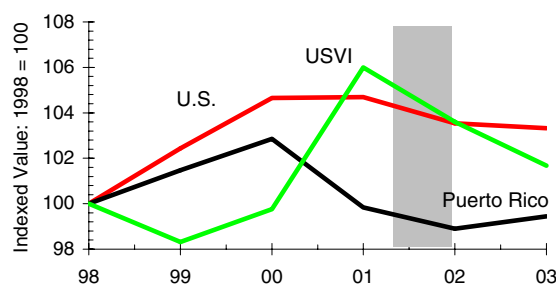
## Puerto Rico and the U.S. Virgin Islands

The Puerto Rico economy contracted more sharply than the nation following the 2001 recession. However, the rate of job loss eased in first half 2003 as manufacturing jobs stabilized. The U.S. Virgin Islands' (USVI) economy has contracted sharply since the 2001 U.S. recession.

- Puerto Rico's employment growth has consistently trailed the U.S. over the past several years. However, employment growth increased 0.8 percent annually in the first half of 2003, marking Puerto Rico's first job growth in two years. Employment trends in the USVI have declined sharply since the 2001 recession (see Chart 1).
- Puerto Rico's employment conditions improved during the first half of 2003, primarily because of reduced job losses in the manufacturing, construction, and trade and transportation sectors (see Chart 2).
- Manufacturing is Puerto Rico's dominant economic sector, accounting for 40 percent of its gross product, more than double the 16 percent share for the U.S. economy. In 2002, employment in Puerto Rico's manufacturing sector fell 8.5 percent, compared with a 6.9 percent decline in the U.S. In first half 2003, however, manufacturing jobs stabilized. The weak U.S. economic environment, the phaseout of section 936, and the implementation of trade liberalization policies have contributed to manufacturing job losses in Puerto Rico over the past several years.
- While lower than the U.S., Puerto Rico has higher business costs compared with its Caribbean neighbors, Mexico, and some Asian countries, which has contributed to a decline in Puerto Rico's labor-intensive manufacturing jobs. For example, the average hourly wage for labor in Puerto Rico is \$12.28, half the U.S. level of \$23.44, but far above the \$2.12 in Mexico and \$7.18 in Singapore. Puerto Rico also faces higher energy costs, because it imports its petroleum products. Industrial electricity measured at cents per kilowatt hour is between 9.34 cents and 15.4 cents. On the U.S. mainland, comparable electricity costs average between 4.5 cents and 8.3 cents, while in Mexico the average is between 5 cents and 6 cents.<sup>1</sup> Offsetting Puerto Rico's higher business costs is its skilled labor force, which is attractive to more capital-intensive, higher-productivity manufacturers such as the pharmaceutical industry.
- Employment in Puerto Rico's construction sector has trended downward during the past two years. After increasing during the 1990s, private construction activity has leveled off,

<sup>1</sup> Costs of Doing Business Chart. *Caribbean Business*. April 24, 2003. p.20.

Chart 1: Employment Trends in Puerto Rico and the USVI Generally Have Lagged the Nation



Source: Bureau of Labor Statistics. 2003 is a six month average. Shaded area denotes recession.

Chart 2: Employment Losses in Puerto Rico's Key Private Sectors Have Been Somewhat Offset by Gains in Government Jobs



Source: Bureau of Labor Statistics. 2003 represents the first six month average over the comparable prior year period.

while public construction has declined. However, plans to construct an additional 2,000 hotel rooms by the end of 2003 and another 1,000 by the end of 2004 may help boost private construction employment.

- The U.S. Virgin Islands' employment declined 2.3 percent in 2002 and 3 percent annually in the first half of 2003. Tourism is the USVI's dominant industry, representing more than 70 percent of gross product. Tourism arrivals in the USVI were down sharply during first quarter 2003, and hotel occupancy levels reportedly were lower than other Caribbean destinations. Announced reductions in airline and cruise ship service to the USVI could hinder tourism traffic. An expansion project for Hovensa, one of the hemi-

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sphere's largest oil refineries and a significant employer in the USVI, is underway.

**Credit quality among insured institutions headquartered in Puerto Rico/U.S. Virgin Islands (PRVI) weakened moderately at the start of the recession, but recently appears to have stabilized.<sup>2</sup>**

- Loan delinquency rates among insured institutions headquartered in PRVI increased since the start of the U.S. recession, but have showed signs of stabilizing. The ratio of loans 30-89 days delinquent to total loans has leveled off (see Chart 3). Historically, past-due and charge-off ratios among banks headquartered in the area have exceeded mainland levels.
- Delinquency rates on consumer and residential real estate loans increased since the start of the economic downturn, but have shown recent improvement. Nonetheless, weak employment conditions in key industries could have a lagged effect on loan quality.

**Exposure to traditionally higher-risk loans remains high among insured institutions headquartered in PRVI.**

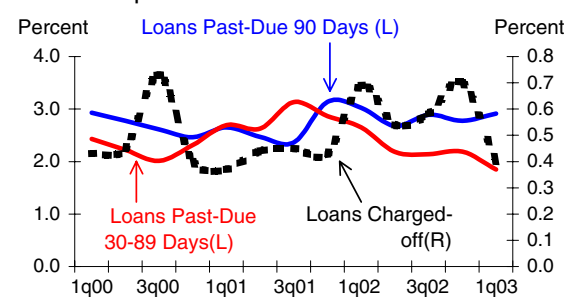
- Consistent with national trends, the percentage of insured institutions with concentrations of traditionally higher-risk loans of at least 300 percent of capital headquartered in PRVI increased during the 1990s economic expansion. The percentage has moderated in recent years, reflective of the focus by some banks on growing consumer banking businesses in off-island markets. While the percentage has moderated in recent years, at 69 percent it remains above the national level of 50 percent (see Chart 4).
- As credit quality typically lags the business cycle, given these concentrations, loan performance likely will remain weak in coming quarters even if the economic recovery strengthens.

**The median net interest margin (NIM) among insured institutions headquartered in PRVI increased somewhat over the past two quarters as funding costs declined.**

- The median NIM of institutions headquartered in PRVI declined during much of 2002 as market interest rates reached historic lows. However, the median NIM rebounded in fourth quarter 2002 and first quarter 2003. Since banks headquartered in PRVI are heavily reliant on market-rate sensitive, noncore funding, the decline in short-term interest rates over the past several years has helped funding costs decline by almost 350 basis points.

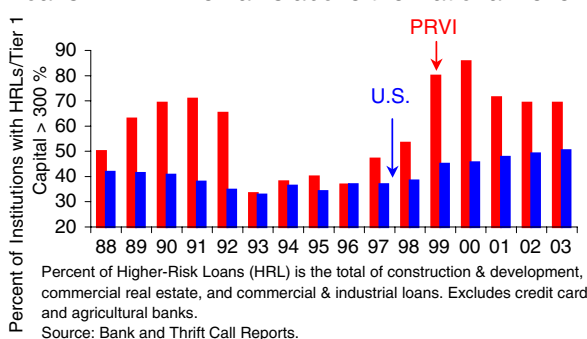
<sup>2</sup> Analysis includes insured institutions headquartered in Puerto Rico and the U.S. Virgin Islands that have been in operation for at least three years as of March 31, 2003, unless otherwise noted.

**Chart 3: Loan Quality among Insured Institutions Headquartered in PRVI Has Stabilized**



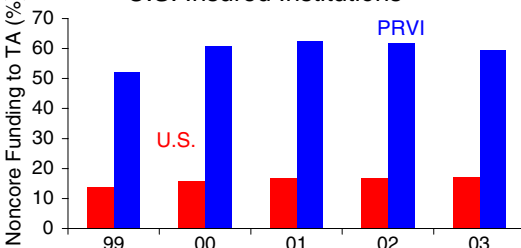
Note: Excludes banks less than three years old. Median data.  
Source: Bank and Thrift Call Reports.

**Chart 4: Exposure to Traditionally Higher-Risk Loans in PRVI Remains above the National Level**



Percent of Higher-Risk Loans (HRL) is the total of construction & development, commercial real estate, and commercial & industrial loans. Excludes credit card and agricultural banks.  
Source: Bank and Thrift Call Reports.

**Chart 5: Use of Noncore Funding at Banks Headquartered in PRVI Far Exceeds That at U.S. Insured Institutions**



Note: Excludes institutions in operation less than three years. Median data displayed.  
Source: Bank and Thrift Call Reports.

- Nevertheless, due to the highly competitive banking market, relatively large unbanked population (estimates indicate that as much as 50 percent of Puerto Rican citizens do not have bank accounts), and tax-advantaged alternatives to bank deposits, raising low-cost deposits locally tends to be challenging in Puerto Rico. Reliance on noncore funding among insured institutions headquartered in PRVI far exceeds that of U.S. institutions (see Chart 5).

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### Puerto Rico & U.S. Virgin Islands

General Information	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
Institutions (#)	13	14	14	15	15
Total Assets (in thousands)	68,380,454	60,852,176	51,995,980	46,930,542	40,436,903
New Institutions (# < 3 years)	0	0	1	1	1
New Institutions (# < 9 years)	3	3	3	3	3
Capital	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
Tier 1 Leverage (median)	6.66	6.39	6.80	6.87	7.17
Asset Quality	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
Past-Due and Nonaccrual (median %)	5.61%	5.77%	5.58%	5.16%	5.65%
Past-Due and Nonaccrual >= 5%	7	10	9	9	8
ALLL/Total Loans (median %)	1.44%	1.26%	1.22%	1.20%	1.40%
ALLL/Noncurrent Loans (median multiple)	0.42	0.43	0.48	0.41	0.55
Net Loan Losses/Loans (aggregate)	0.69%	0.94%	1.01%	0.98%	0.76%
Earnings	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
Unprofitable Institutions (#)	1	4	1	0	1
Percent Unprofitable	7.69%	28.57%	7.14%	0.00%	6.67%
Return on Assets (median %)	1.19	0.98	0.98	0.97	1.08
25th Percentile	0.70	0.00	0.62	0.70	0.64
Net Interest Margin (median %)	3.34%	3.50%	3.64%	4.14%	4.22%
Yield on Earning Assets (median)	5.88%	6.64%	8.41%	8.20%	7.87%
Cost of Funding Earning Assets (median)	2.63%	3.41%	5.20%	4.61%	4.01%
Provisions to Avg. Assets (median)	0.31%	0.49%	0.34%	0.35%	0.33%
Noninterest Income to Avg. Assets (median)	0.54%	0.53%	0.57%	0.58%	0.71%
Overhead to Avg. Assets (median)	2.28%	2.36%	2.27%	2.53%	2.85%
Liquidity/Sensitivity	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
Loans to Deposits (median %)	94.40%	92.86%	90.45%	90.76%	82.97%
Loans to Assets (median %)	53.92%	54.52%	59.53%	62.55%	55.49%
Brokered Deposits (# of institutions)	10	11	11	10	10
Bro. Deps./Assets (median for above inst.)	15.13%	11.99%	4.56%	8.55%	6.93%
Noncore Funding to Assets (median)	59.36%	61.66%	59.94%	60.76%	51.27%
Core Funding to Assets (median)	26.50%	28.10%	30.80%	30.33%	40.59%
Bank Class	Mar-03	Mar-02	Mar-01	Mar-00	Mar-99
State Nonmember	12	13	13	13	13
National	0	0	0	0	0
State Member	1	1	1	1	1
S&L	0	0	0	0	0
Savings Bank	0	0	0	1	1
Mutually Insured	0	0	0	0	0
MSA Distribution	# of Inst.		Assets	% Inst.	% Assets
San Juan-Bayamon PR PMSA	10		59,421,471	76.92%	86.90%
No MSA	2		125,713	15.38%	0.18%
Mayaguez PR	1		8,833,270	7.69%	12.92%